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Lloyd, Roger
Update on the
Legislative
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Senate Bill 378
recommendations

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Update on the Legislative Finance Committee Senate Bill 378 Recommendations

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A Report Prepared for the

Legislative Finance Committee

by

Roger Lloyd
Associate Fiscal Analyst
November 18, 1994

Legislative Fiscal Analyst

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TON SCHENCK

Room 105 · State Capitol
P.O. Box 201711
Helena, Montana 59620-1711
(406) 444-2986
FAX (406) 444-3036

STATE OF MONTANA
Office of the Legislative Fiscal Analyst

DATE: October 13, 1994

TO: Legislative Finance Committee

FROM: Roger Lloyd
Associate Fiscal Analyst

RE: Up-date on the Legislative Finance Committee SB 378 Recommendations

This report addresses issues related to the recommendations of the Legislative Finance Committee (LFC) as a result of its review of state special revenue accounts and statutory appropriations (SB 378).

Draft Legislation

Greg Petesch, Code Commissioner of the State of Montana, has drafted legislation to implement the committee's recommendations. Two bills were drafted so that the clean-up legislation is kept separate from the substantive legislation (copies enclosed).

Legal Opinion Received

The committee requested a legal opinion from Mr. Petesch on the legality of depositing the interest and income from the public school trust to the general fund (copy attached). Mr. Petesch concluded that as long as the money is equitably apportioned to public elementary and secondary school districts, it does not matter which treasury fund the money is deposited into. Depositing the funds in the general fund (or subfund) would provide the accounting necessary to show the dispensation of the funds. Based on this opinion, the committee may wish to include the public school trust interest and income revenue in its decision to de-earmark revenue sources from the school equalization account (SEA) in the general fund. All revenue sources currently deposited to the SEA would then be deposited to the general fund.

OPTION: De-earmark the interest and income revenue from the SEA to the general fund.

Renewable Resource Bond Debt Service

The committee recommended that the coal tax allocations for renewable resource loan debt service and renewable resource development bonds be combined with six other allocations and deposited into a single state special revenue account. The legislature would appropriate funds for those eight uses from this account. At the September LFC meeting, staff from the Department of Natural Resources (DNRC) testified that removal of the direct allocations for renewable resource bonds could jeopardize the program. They indicated that since the timing of loan repayments is uncertain, coal tax revenue may be needed to meet bond debt service requirements. DNRC staff expressed concern that, since the amount of money appropriated by the legislature could vary widely, the amount of funds pledged for debt service may not be sufficient to meet the obligation. Currently, the coal tax money is pledged to meet debt service if needed. If the funds are not used, they are swept annually into the renewable resources grant and loan account to be appropriated by the legislature for that use.

The Office of the Legislative Fiscal Analyst (LFA) and DNRC staff questioned Mae Nan Ellingson, the state's bond counsel at Dorsey and Whitney concerning the committee's recommendation. Bond counsel concluded that, since the amounts that would be appropriated by the legislature could vary widely from year to year, the legal requirement under section 85-1-619(1), MCA, that the legislature determine that resources pledged and appropriated are sufficient for prompt and full payment, may not be met. Although this section reserves the right of the state to modify revenues pledged for debt service, the aggregate resources pledged and appropriated must be determined by the legislature to be sufficient for debt service. Bond counsel indicated that because of the uncertainty of the amount of money that could be appropriated, the committee's recommendation may not meet the requirement of this statute. Bond counsel and Greg Petesch both stated that if the committee were to subject this funding source to uncertain appropriations, another revenue source to pledge for debt service should be found. The bond counsel also stated that the bond ratings would not be affected by the committee's recommendation.

OPTION 1: Exclude the coal tax allocations for renewable resource loan debt service and renewable resource development bonds from the recommendation to combine coal tax allocations, but recommend that the LFC review this issue in the interim.

OPTION 2: Include the allocations into the one account, but find another revenue source to pledge for debt service.

OPTION 3: Eliminate the two current allocations (the funds would go to the general fund by default), but examine alternate revenue sources to pledge for debt service.

OPTION 4: Do not change the committee's recommendation.

Elimination of State Special Revenue Accounts

The committee recommended that staff notify the Department of Administration (DofA) that 61 state special revenue accounts could be deleted, and that staff monitor the process. In addition, the committee recommended that (DofA) review the necessity of 20 accounts. The department is currently reviewing these accounts. In some cases, amendments to statute may be required. Such amendments could be incorporated in the committee bill.

OPTION: Amend statute as needed to eliminate accounts based on staff monitoring of the accounts.

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Montana Legislative Council

Legal Services Division

Room 138 • State Capitol
Helena, Montana 59620-1706
(406) 444-3064
FAX (406) 444-3036

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Legal Researcher
DOUG STERNBERG

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September 15, 1994

Roger Lloyd
Associate Fiscal Analyst
Office of the Legislative Fiscal Analyst
Room 105, State Capitol
P.O. Box 201711
Helena MT 59620-1711

Dear Mr. Lloyd:

I am writing in response to your request for an opinion on behalf of the Legislative Finance Committee concerning de-earmarking revenue sources for school equalization aid. Your specific question concerns the propriety of depositing the interest and income from the public school fund established by Article X, section 2, of the Montana Constitution in the state general fund.

The interest and income of the public school fund are governed by The Enabling Act and the Montana Constitution. The public school fund consists of the proceeds of lands granted to the state for public school purposes. The conditions imposed on the lands and the funds resulting from their sale or lease are also found in The Enabling Act and the Montana Constitution. The case of State ex rel. Koch v. Barret, 26 Mont. 62 (1901), dealt with the propriety of leasing the granted lands, as opposed to selling them and investing the proceeds. The court found that the lands granted by Congress became a trust. The funds derived from the lands were trust funds, to be devoted exclusively to the purpose of the trust through the agency of the state. The court stated:

> . . . the manifest intention of congress was to create a permanent endowment, which was to be preserved inviolate; and to require that the revenues derived therefrom should be faithfully applied to the support of the institutions created, and not be diverted to other purposes. So long as this intention is carried out, we think it makes no difference what mode is adopted. The grant was made in view of conditions existing at the time, and others which might arise. Barret at 70.

The propriety of investing the public school fund in farm mortgages was presented to the courts in the case of State ex rel. Evans v. Stewart, 53 Mont. 18, 161 P. 309 (1916). The court upheld the validity of investing in farm mortgages. The court discussed the limitations contained in The Enabling Act as follows:

> With respect to the lands granted for common school purposes, the Enabling Act fixes a minimum sale price and declares that the proceeds from such sales, together with five per cent of the proceeds from the sales of public lands in the state, shall constitute a permanent school fund the interest from which only shall be expended. It also provides that the lands granted may be leased under regulations prescribed by the legislature of the state, with a limitation upon the term of any such lease and upon the quantity which may be let to any individual, company or corporation.
> . . . The only limitation imposed with reference to the other grants enumerated above is that: "The lands granted by this section shall be held, appropriated, and disposed of exclusively for the purposes herein mentioned, in such manner as the legislatures of the respective states may severally provide." It will thus be seen that the Enabling Act does not attempt to regulate the manner in which the permanent funds derived from these grants shall be invested; and, as the Farm Loan Act deals only with the investment of those funds, no possible conflict can be discovered between the two Acts. Stewart at 22.

It was recognized in the case of Newton v. Weiler, 87 Mont. 164, 286 P. 133 (1930), that the constitutional provisions relating to trust lands are limitations upon the power of disposal by the Legislature. The Weiler court found that the leasing system was proper. It was not a condition precedent to require the sale of land and investment of the proceeds prior to using income generated by the lands for their specified purposes. The Weiler decision conforms to the general rule that the constitution is a limit on rather than a grant of legislative authority. State ex rel. Evans v. Stewart, supra, and State ex rel. DuFresne v. Leslie, 100 Mont. 449, 50 P.2d 959 (1935).

Later litigation concerned the use of funds derived from oil and gas leasing of land grants. A pooling arrangement was challenged in Toomey v. State Board of Land Commissioners, 106 Mont. 547, 81 P.2d 407 (1938). The court found that pooling of school lands with private lands for unit operation for the production of oil and gas and the apportionment of the royalties from the pool are not violative of The Enabling Act, which grants general authority to lease school lands for the extraction of oil and gas. If the pooling arrangement is treated as the sale of an estate or interest in the school lands, it still does not violate The Enabling Act because the requirement of public sale after advertising applies only when the whole interest in land is sold. When an estate or interest in the land is sold, the full market value of the estate or interest disposed of is ascertained "in such manner as may be provided by law". The Legislature is given ample power to determine the method by which to ascertain the full market value of the estate or interest.

The problems engendered with the customary methods of oil leasing were encountered in the 1950s. The court found that the "royalty" collected under an oil and gas lease on school lands is required to be credited to the permanent school fund since royalties are based on production and production is a permanent disposition of an estate in the land. "Rentals" or cash bonuses collected under an oil and gas lease were required to be placed in the common school interest and income fund available for the maintenance and support of schools and institutions. State ex rel. Dickgraber v. Sheridan, 126 Mont. 447, 254 P.2d 390 (1953). This holding was clarified in State ex rel. Strandberg v. State Board of Land Commissioners, 131 Mont. 65, 307 P.2d 234 (1957). The court found that the Legislature, in leasing oil and gas lands, is under an obligation to obtain the full market value of the estate or interest disposed of on a rental basis, as well as for the sale of the land itself or the oil and gas in and under the land. There could be no sacrifice of the rental for additional royalty without, at the same time, violating Article XVII, section 1, of the 1889 Constitution. The court upheld the legislative scheme because no hard-and-fast rule could be devised for determining the full market value of oil and gas leases involving both rentals and royalties.

The cases interpreting The Enabling Act and the constitutional provisions governing the land grant funds establish the parameters within which the Legislature may act in dealing with the land grant trusts and the income derived from the funds. The trusts may be invested as the Legislature sees fit, so long as the investment plan conforms to Article VIII, section 13, of the Montana Constitution. In the event that the investments result in losses to the funds, the constitution requires that the losses be made good. The income from the public school fund must be used for a purpose for which the trust can be used.

Article X, section 5, of the Montana Constitution provides:

> **Public school fund revenue.** (1) Ninety-five percent of all the interest received on the public school fund and ninety-five percent of all rent received from the leasing of school lands and all other income from the public school fund shall be equitably apportioned annually to public elementary and secondary school districts as provided by law.
>
> (2) The remaining five percent of all interest received on the public school fund, and the remaining five percent of all rent received from the leasing of school lands and all other income from the public school fund shall annually be added to the public school fund and become and forever remain an inseparable and inviolable part thereof.

Section 20-9-341, MCA, defines "interest and income moneys" for purposes of implementing Article X, section 5, of the Montana Constitution. At the time of the Sheridan case, the interest and income from the public school fund were deposited in the common school interest and income fund. Section 20-9-342, MCA, currently requires the deposit of interest and income money into the state special revenue fund for state equalization aid. The purpose of the Treasury Fund Structure Act, as stated in section 17-2-101, MCA, is:

> . . . to simplify the accounting system and treasury fund structure of the state, to make possible the full utilization of modern accounting methods, to provide the legislature with a greater measure of control over public moneys, and to enable the financial records of the state to accurately reflect the state's revenues, expenditures, expenses, and financial position in accordance with generally accepted accounting principles.

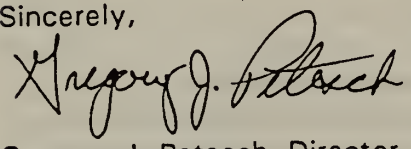
Section 17-2-102, MCA, provides for the fund categories and types within the state treasury. Section 17-2-105, MCA, requires the State Treasurer to record receipts and disbursements for treasury funds. Section 17-2-107, MCA, requires the Department of Administration to record receipts and disbursements for accounting entities within treasury funds.

There is no constitutional impediment to depositing the interest and income from the public school fund in the state general fund so long as the money is equitably apportioned annually to public elementary and secondary school districts. While it may be easier from an accounting viewpoint to identify the interest and income money in a special revenue account, that factor is not determinative.

It does not matter which state treasury fund the interest and income money from the public school fund is deposited into and paid out of so long as the money is equitably apportioned to public elementary and secondary school districts.

If you have any questions or if I can provide additional information, please feel free to contact me.

Sincerely,



Gregory J. Petesch, Director
Legal Services Division

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